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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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Arizona Corporation Commission
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In the Matter of the Investigation into Preferred Carrier Arrangements and Other Potentially Anti-competitive Practices involving Service to Residential or Business Developments	DOCKET NO. T-00000K-04-0927 Accipiter Communications' Supplemental Comments Regarding Preferred Provider Agreements

Accipiter Communications Inc. ("Accipiter"), by and through undersigned counsel, hereby submits these supplemental comments in the above-referenced generic docket ("Generic Docket") and proposes that the Arizona Corporation Commission ("Commission") take certain actions including the adoption of regulations relating to problematic preferred provider agreements/arrangements ("PPAs"). Additionally, in a separate pleading filed contemporaneously herewith, Accipiter has submitted a motion requesting that a procedural conference be scheduled for the purpose of establishing dates for an evidentiary hearing to consider the issues raised in this Generic Docket.

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1. Procedural History.

On 23 December 2004 on its own initiative the Commission opened this Generic Docket in order to examine PPAs and other potentially harmful anti-competitive practices by telecommunications providers and other entities. The opening of this Generic Docket was in partial response to the facts and circumstances stemming from the complaint proceeding captioned *In the Matter of the Formal Complaint of Accipiter Communications, Inc., Against Vistancia Communications, L.L.C., and Cox Arizona Telecom, L.L.C.*, Docket No. T-03471A-05-0064 (the "Vistancia Complaint Docket"). The Vistancia Complaint involved alleged anti-competitive practices through the use of PPAs by a competitive local exchange carrier ("CLEC"). In November of 2005, the corporate parties to the Vistancia Complaint Docket entered a settlement agreement that does not affect their respective positions in this Generic Docket. (The Commission's review of that settlement is pending.)

On 9 March 2005 Commission staff ("Staff") issued its first set of data requests to various Arizona telecommunications providers in the Generic Docket.

On 25 April 2005 Staff filed a Motion to Compel seeking an order directing Cox Arizona Telecom, LLC ("Cox") to submit its response to Staff's first set of data requests.

On 4 May 2005 a procedural conference was held before hearing officer Dwight D. Nodes regarding Staff's Motion to Compel Cox's response.

On 12 March 2007 Staff issued its second set of data requests to various telecommunications providers.

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On 22 March 2007 Accipiter filed comments in the Generic Docket. On 3 April 2007 AT&T filed its response to Staff's second set of data requests. On 18 April 2007 the Arizona Local Exchange Carrier Association ("ALECA") filed comments and on 1 May 2007 Qwest filed comments in the Generic Docket.

2. Introduction

The only PPAs that are of concern to Accipiter usually take the form of local exchange carrier ("LEC") agreements that are designed to facilitate the installation of a sole provider for the initial telecommunications facilities within large new master-planned communities ("MPCs") in remote unserved areas. A telephone carrier should not be surreptitiously entering an unserved area under a secret and confidential agreement that all but guarantees that there will not be it will not have any competition for telecommunication services within the MPC. In the most problematic PPA for telephone services, the MPC's developer/funder ("Financier") subsidizes the LEC's facilities. The LEC subsequently pays its Financier rebates derived from disposing of a percentage of the subscriber revenues collected from ratepayers in the MPC. The rebates continue as a perennial encumbrance; they are not conditioned on mere repayment of a loan approved by the Commission. The magnitude of the payments depends on the efficacy of the Financier's efforts to keep competition out of the MPC. Through these PPAs the LEC is paying others to do what at the very least be inappropriate for the LEC to do itself; exclude the competition to the

everlasting mutual benefit of both the preferred provider and the Financier. This stream of payments for protection from competition must not be condoned.

As a solution Accipiter is not proposing that PPAs be eliminated through some form of all-encompassing blanket regulation prohibiting their use. Instead, the Commission should consider the desirability of full public disclosure before a PPA can take effect:

- The Commission should be informed by public filing about a pending PPA including the long-term financing aspects and other evidence of any encumbrance or disposition of an asset;

- The consumers should be made aware of the role their own payments have in hindering competition in their MPCs by informing them of the amounts of their phone or homeowners' association dues payments that are being funneled by preferred providers to Financiers; and

- The ILEC and other competitive telephone providers should be informed of all terms in PPAs making them aware of the embedded economic disincentives in Arizona's numerous MPC developments and allowing them to make informed business decisions about new investments.

Through this Generic Docket the Commission's examination in detail of the more problematic PPAs utilized in remote unserved areas can be expected to reveal how competition is destroyed as follows:

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1) Non-tariffed covert terms are concealed from potential competitors effectively suppressing competition in MPCs;

2) Consumers are unaware that their telephone provider shares with the Financier their ongoing monthly payments as an incentive to hinder consumer choice;

3) The safeguards ordered by the Commission to prevent a CLEC from creating a monopoly in a previously unserved area are evaded;

4) Long-term encumbrances of preferred provider assets/revenues are created;

5) The concept of "public utility easement" is flouted under a bogus claim of protecting private property rights; and

6) The critical "first mover" advantage is bestowed on the preferred provider as part of a foundation for construction of a *de facto* monopoly.

Unlike many other states, the Arizona Corporation Commission already has sufficient authority to address the abuses presented by problematic PPAs. Accipiter has outlined the Commission's authority in section 4 below. We also respond to the concerns of Qwest *et al.*, who have been otherwise supportive. Importantly no new regulatory scheme is required. Instead, a policy of openness and public disclosure is the key.

3. <u>Secrecy Begins the Process of Keeping Out Competition</u>.

A meaningful inquiry into PPAs in Arizona is not an easy task. With a self proclaimed need for secrecy, the telephone providers that use PPAs impose ignorance on the Commission, on consumers and on competing telephone providers. LECs that enter

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into PPAs usually claim that their agreements contain confidential information, proprietary marketing strategies and other sensitive business data. They cloak PPAs in secrecy by requiring that the terms be kept confidential. For example Cox Arizona Telecom demands that anyone who has reason to view such an agreement must first execute an onerous confidentiality agreement before any terms of its PPAs are discussed or divulged. This very effectively prevents public exploration of what is really going on inside these secret agreements.

Accipiter considers public input to be critical to the Commission's ability to discharge its duties. However, the preferred provider keeps the public in the dark. Without public knowledge of the various terms included in problematic PPAs and knowledge of what is really going on with these agreements, it is futile to take public comment. To begin a public discussion of the issues, Accipiter offer the following description of a PPA recently provided to the Commission by one of the Arizona CLECs that regularly employs secret or "confidential" PPAs. In the Vistancia Complaint docket Cox explained to the Commission "what actually transpired" in a PPA negotiation:

> The Commission must understand what actually transpired between the parties. The Vistancia development is somewhat remote from the then-existing communication services facilities. Naturally, the Developer wanted a variety of communications services available for its first homeowner and to every homeowner thereafter, even though the population would be insufficient in the beginning to support the cost of extending services to the entire community. As this Commission well knows, the Valley is undergoing amazing growth, and Cox has many options from which to

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> choose when deciding where to invest its limited capital resources. Thus, it is not surprising that, when the Developer approached Cox to discuss communications services for this Vistancia development, Cox was simply unwilling, without some financial incentives, to make the enormous capital expenditures necessary to ensure that services were available to the first homeowner. Cox calculated what it believed would be an acceptable rate of return on its capital investment, as well as the costs of extending services to the development, and determined what capital contribution and other incentives from the Developer were necessary to make Cox's investment reasonable from a business standpoint. The Developer agreed to make this capital contribution and to provide certain marketing incentives. However, the Developer recognized that, at some point, Cox would more than recoup its capital contribution, and also wanted to recoup its capital investment, share in the benefits that Cox derived from having access to the Developer's property and be compensated for its marketing efforts on behalf of Cox. Thus, the parties agreed to a revenue-sharing arrangement whereby, once sufficiently high levels of penetration were achieved, the Developer could recoup some of its capital contribution and participate in the revenue derived from Cox's sale of communications services at the development. There was never the necessary intent to form or the attributes of a profit-and-loss-sharing joint venture.

Cox Arizona Telcom, LLC's Reply to Staff Response Regarding Accipiter Complaint (Public Version), Docket No. T-03471A-05-0064, docketed May 31, 2005.

Cox describes its PPAs as negotiated financial arrangements through which it obtains the capital it needs to extend its network into new MPCs. According to Cox, it offers a mechanism for the Financier to recover its capital only if certain levels of market penetration are achieved. The funding is recovered by the Financier only when elevated

market penetration levels are reached with the amount of each payment resting on a predetermined percentage of the ratepayer revenues.

To Accipiter's knowledge, and under pressure from the Commission, Cox has only once allowed public disclosure of its PPAs in Arizona. That was in the Vistancia Complaint Docket. In preparation for a hearing in that docket, Cox publicly filed copies of its Co-marketing Agreement and its Property Access Agreement, both dated April 8, 2003. *See* Exhibits LT1 and LT2 to the Direct Testimony of Lynda Trickey, docketed April 5, 2006, *In the Matter of the Formal Complaint of Accipiter Communications, Inc., Against Vistancia Communications, L.L.C., and Cox Arizona Telecom, L.L.C.*, Docket No. T-03471A-05-0064. In those PPAs Cox contracted to kickback a percentage share of its revenues to the Financier on an escalating scale ranging from 3 percent up to 20 percent depending on the type of service and on the market penetration achieved. From Accipiter's viewpoint, these PPAs are nothing less than contracts to pay others to do what may be unlawful (or at least inappropriate) for Cox itself to do—exclude the competition.

However, even if we accept Cox's peculiar contention that it does not enter into PPAs to exclude competition (which Accipiter does not accept), it is clear from this brief description that Cox treats PPAs as a form of non-recourse financing where the Financier (who controls the MPC) is granted what is typically referred to as an "equity kicker" in the project. Also the Financier is compensated for the efficacy of its efforts to exclude competition thereby increasing the market penetration for the preferred provider which then

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increases the payment stream to the Financier. In other words, the better the Financier keeps out the competition, the higher the capital returns to the Financier, the higher the capital cost to the preferred provider, and the fewer and more expensive choices for the consumers. A public service corporation in Arizona is not supposed to encumber its gross revenues without a Commission order. It is inappropriate at best for a LEC to accept secret funding and encumber its revenues to pay off a Financier for decades to come founded on how effectively competition is stifled.

4. <u>This Is *Not* A Call For A New Far-Reaching Regulatory Scheme—The Commission Already Has the Power.</u>

In Arizona the needed laws and regulatory powers are already in place to deal properly and appropriately with problem PPAs. Since these agreements are usually kept secret, outside parties (including the consumers) have no idea what they are encountering; they are unaware of the high economic barriers that have been erected to hinder the entry of competitive telecommunications services into Arizona's numerous MPCs. These three simple informative steps would harness the self-corrective forces inherent in open competitive markets to bear against the more problematic aspects of PPAs:

1) inform the Commission,

2) inform the consumers, and

3) inform the potential competitors.

Through this approach Accipiter believes that many of the unwanted anti-competitive aspects of problematic PPAs can be significantly commuted in Arizona while

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at the same time maintaining open, robust and innovative competition between telephone service providers with a minimal amount of regulatory oversight.

Under the Arizona Constitution Article 15, Sections 3, 4, and 6, the Commission already has the responsibility and power to review and regulate preferred provider agreements. More specifically under Arizona Statutes A.R.S. §§ 40-285 the Commission is also slated with the responsibility to address the peculiar use of PPAs as unauthorized encumbrances and dispositions of LEC facilities and systems.

Under Article 15 of Arizona Constitution the Commission has plenary power to regulate the conduct of business of public service corporations in this state. Article 15, section 3 of the Arizona Constitution provides: "The Corporation Commission shall have full power to, and shall . . . make reasonable rules, regulations, and orders, by which [public service]corporations shall be governed in the transaction of business within the State, and may prescribe the forms of contracts and the systems of keeping accounts to be used by such corporations in transacting such business, and make and enforce reasonable rules, regulations, and orders for the convenience, comfort, and safety. . . of the . . . patrons of such corporations . . . ." By anyone's definition PPAs are contracts involving the transaction of public service corporation business within Arizona. Our State Constitution Article 15, section 3 grants the Commission direct authority to regulate PPAs. Also Article 15, section 4 of the Arizona constitution provides: "The Corporation Commission, and the several members thereof, shall have the power to inspect and investigate the property,

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books, papers, business, methods, and affairs . . . of any public service corporation doing business within the State . . . ." PPAs are part of the books, papers, business, methods, and affairs of public service corporations. Therefore, the Commission has the power to address PPAs.

Additionally, the Commission's powers may be extended by statute under Article 15, section 6, of the Arizona Constitution: "The law-making power may enlarge powers and extend the duties of the Corporation Commission . . . ." If the direct constitutional grant of power to the Commission were not enough to provide ample authority to regulate PPAs (and it is), the Legislature by statute assured the vesting of the authority and the obligation to address PPAs as they are being used in Arizona today.

Under A.R.S. § 40-285(A) a public service corporation shall not encumber any part of its plant or system without Commission authorization:

> A public service corporation shall not sell, lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its railroad, line, plant, or system necessary or useful in the performance of its duties to the public, or any franchise or permit or any right hereunder, nor shall such corporation merge such system or any part thereof with any other public service corporation without first having secured from the commission an order authorizing it so to do. Every such disposition, encumbrance or merger made other than in accordance with the order of the commission authorizing it is void.

A.R.S. § 40-285(A).

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As described by Cox, PPAs encumber and otherwise siphon off and assign away a share of the revenues from entire areas or MPC subsets of the LECs systems and customer base for decades.

The legislature further recognizes the Commission's jurisdiction over financing of a public service company and even mandates that the Commission review the debts of any public service companies incorporated in Arizona. A public service corporation's right "to issue stocks and stock certificates, bonds, notes and other evidence of indebtedness," is a "special privilege" with control vested in the State and "exercised as provided by law and under rules, regulations and orders of the Commission." A.R.S. § 40–301(A) (emphasis added). Under A.R.S. § 40-301(B), an Arizona public service corporation is not even allowed to issue evidence of indebtedness unless it is first "authorized by an order of the Commission." This is a legislative acknowledgement of the Commission's authority to address debts, an authority that is mandated with regard to instate public service companies.

The statutory criteria for approving a request to issue additional indebtedness is also helpful when considering PPAs that are often used as a form of financing for the LEC. In A.R.S. § 40-301(C) it states, "The commission shall not make any order . . . granting any application [to issue evidences of indebtedness] unless it finds that such issue is for lawful purposes which are within the corporate powers of the applicant, are compatible with the public interest, with sound financial practices, and with the proper performance by the

applicant of service as a public service corporation and will not impair his ability to perform that service." (Emphasis added.) As the Commission explores and considers PPAs, it may be helpful to weigh these same criteria.

Moreover, there is precedent for the Commission's review and approval of PPAs. To Accipiter's knowledge, the only PPAs that have been reviewed by the Commission were subject to regulatory proceedings and approved by an order of the Commission. These are the two agreements that USWest (now Qwest) entered into with the developers of the Civano and Anthem MPCs. *See*, Commission Decision No. 61626, Docket Nos. T-01051B-98-0708, T-01051B-98-0731 & T-01051B-99-0057 (docketed May 1, 1999). In hindsight one may question the wisdom of the extension fee waiver being linked to market penetration, but at least that early attempt to review and regulate PPAs did not create a revenue encumbrance or kickback scheme funneling funds back to the Financier far into the future. In Arizona these schemes are currently employed without any authority from the Commission.

One CLEC recently claimed to the Commission that its PPAs with these kickback schemes are merely what the Commission already approved in the Civano and Anthem dockets. However, there are huge differences between what Accipiter is encountering today and what was approved by the Commission for USWest in 1999, not the least of which is granting the Financier a rebate in the form of revenue splitting as an equity kicker

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in the long-term revenue stream paid by consumers of telecommunications services and the resulting corruption of the public utility easement concept.

The Commission has both the jurisdiction and the responsibility to address PPAs as they are currently being used by LECs in this state.

5. Accipiter's Ignorance Should Not be the Commission's Ignorance.

Accipiter cannot imagine any circumstances that would justify Commission approval of a financing scheme that allows a carrier to reward a Financier in ever-increasing amounts on the footing of how effectively the Financier has stifled competition!

Accipiter is left to stumble over PPAs in its service area by happenstance. The parties that are utilizing a PPA do not publicly announce when it is created. Accipiter does not even know if it is aware of all of the PPAs in its service area. Typically the existence of a PPA is not revealed to Accipiter until an MPC approaches the construction phase and Accipiter requests access to the PUEs. At that time the existence of a PPA is revealed by the parties in an effort to persuade Accipiter to abandon voluntarily the service area. Supposedly any attempt to offer competing services where a PPA is in place would be too onerous a task for any competing telephone provider to consider seriously. Accipiter's knowledge of the terms included in PPAs is often severely limited or in some cases may be nonexistent. The parties to these agreements claim that confidentiality clauses in their PPAs conveniently prohibit disclosure of the terms.[1]

[1]. For example, Cox conceals its plans for expansion of its service area despite the Commission's express requirement in Decision No. 60285 (July 2, 1997) that granted

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Admittedly Accipiter's experience with PPAs is limited to its rural service area which is less than one percent of the State's area. The preferred provider and the Financier try to keep Accipiter in the dark, but Accipiter does not believe the Commission should be deliberately deprived of operative facts for the other ninety-nine plus percent of Arizona. The Commission is entitled to have the benefit of informed comment in this Generic Docket from all interested groups regarding these agreements to keep out competition. To be effective, the comment and input must include not only the parties that want to enter into such agreements; it should include any LECs that may want to offer competing services; and it most certainly should include the consumers that are ultimately paying the price for rewarding efforts to deprive consumers of the choice of providers, competing technologies, competing tariffs and other benefits that are fundamental to a robust competitive market for telephone services. This means no confidentiality provisions may be allowed to hide secret payments to exclude competition, no matter how sensitive or embarrassing a preferred provider may consider that information to be.

6. <u>Agreements To Keep Out Competition are Effective.</u>

PPAs can be amazingly effective at keeping out the competition. The PPAs described herein are unique financing instruments that obligate a public service company to rebate significant amounts of cash for many years into the future. These agreements

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Cox's application for a Competitive CC&N where Cox was ordered to provide advance notice of the specific territories where it intends to provide telephone service. As a result, Accipiter has no notice of where Cox may be heading next.

normally are void unless approved pursuant to an order of the Commission. A.R.S. 40-285(A).

Without any review or approval by the Commission, this PPA concept has been stretched into extended kickback schemes set up to purchase protection for its territory for decades. Under these forms of PPAs, the Financier continues to be paid year after year to keep out the competition.

Experience demonstrates the power of these fabricated revenue streams to exclude competition. The major LECs including former Bell operating companies like Qwest and AT&T (formerly SBC) have demonstrated that they abandon MPCs that fall under these or similar kinds of PPAs. Qwest gave up its opposition to Accipiter's request to transfer Qwest territory within Vistancia only after it became clear that Cox had already entered into a PPA. Other examples of ILEC abandonment can be found in the materials that AT&T submitted in response to Staff's Second Set of Data Requests in this docket. In its response AT&T identified two regulatory petitions that it filed within the past year with the Florida Public Service Commission. AT&T requested to be relieved of its carrier of last resort ("COLR") obligations in two MPCs that AT&T contended were so onerous as to make the ILEC's entry into those markets uneconomic. The PPA bestows on the preferred provider the invaluable "first-mover" advantage, another sturdy component in building a *de facto* monopoly. Consumer choice between competing telecommunications services providers and technologies should not be determined by which carrier can furtively fashion

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the largest long-term revenue stream paid to a Financier, but this appears by stealth to have become the pattern in Arizona today.

Accipiter has run into significant obstacles in all of the four MPCs in its service territory and will offer testimony on this subject. This past winter Accipiter began meeting with the developer of Sun City Festival ("SCF"). Accipiter representatives have attended weekly onsite utility coordination meetings since January. Even with these coordination efforts, on April 23, 2007, Accipiter learned (from another LEC) that the Wickenburg School District and its architect had been told by the CLEC and the developer that there was no other phone company in SCF and that the CLEC was their only choice for service. The CLEC's lone service was set to be discussed the next morning at a pre-construction meeting with the School District, the CLEC and the developer. Accipiter contacted SCF and was informed that Accipiter could not provide service to the planned new school facilities because the trenches were already closed, the streets paved and the landscaping in place. On closer inspection it was apparent that the existing state of construction was not nearly as advanced as the developer portrayed.

Cox contends that its tardy decision to enter the Anthem market (where USWest was the preferred provider) demonstrates that even when Cox is not the preferred provider, market entry by a competitor into a PPA area is possible. However, if the developer at Anthem was being paid millions of dollars for decades into the future to continue efforts to

exclude competition, Cox's tardy offer of competing services in that MPC would most likely have been undermined or never attempted.

7. **Public Utility Easements are a Public right.**

Accipiter echoes Qwest's concerns regarding overreaching regulation. Accipiter agrees with Qwest that the problem is not with access arrangements to multi-dwelling units or with single owner multi-tenant commercial buildings. Accipiter also points out that the legislature recently enacted A.R.S. §§ 33-2301 & 2302 protecting commercial building owners' rights to select providers that are allowed access to their buildings. Accipiter commends and has no quarrel with that political decision protecting private property rights. MPCs typically convert privately owned vacant land to public streets with public utility easements ("PUEs") to allow access to and subsequent sale of homes, buildings and lots to the public. After declaring the intent to create a public subdivision (but technically prior to the full public dedication and acceptance by a municipality) PPAs are used to exclude competition by hindering access (under a fake claim of private property rights) while the MPC is under construction. Thus PPAs in effect are used to stymie competing providers from access to the trenches that are all the while fully intended to be PUEs. Under these PPAs the decisions as to which provider is ultimately allowed to serve a consumer and which providers are excluded from the premises are not made by the homeowner and consumer of the service. Instead the choice between providers is clandestinely imposed on the buyers in the MPC.

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Qwest also confirms that public utility easements are a hollow gesture without the cooperation and notice needed to allow competing providers to install their facilities along with the other utilities and before the trenches are closed. Accipiter also agrees with Qwest's concern that marketing arrangements with developers may serve a legitimate purpose in a competitive market for telecommunication services. Finally, private communications easements through public right-of ways should be prohibited.

8. <u>There Should Be Commission Hearings to Address Secretive (Covert) PPAs.</u>

Covert PPAs must not be permitted further to hinder competition in Arizona through innovative financing arrangements where the Financier in control of the MPC is paid to exclude competition. These PPAs are evidence of encumbrances and dispositions and should be evaluated by the Commission and treated as such. How many millions of dollars are Arizona LECs going to rebate under PPAs? How many more millions of dollars will be paid out for efforts to exclude competition before these contract debts will be paid? Accipiter does not know the answers to these questions, but the answers should be provided to the Commission through evidentiary hearings in this Generic Docket which was wisely and expressly initiated by the Commission for these purposes.

9. <u>Conclusion</u>

Consumers should be afforded the opportunity for choice of telecommunications providers, technologies, services and tariffs. PPAs that are fashioned to pay others to destroy competition are repugnant to maintaining a true marketplace. Accipiter believes

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that through evidentiary hearings in this Generic Docket, the various issues can be fully explored and regulations can be adopted to safeguard competition and customer choice.

RESPECTFULLY SUBMITTED this 17th day of July, 2007.

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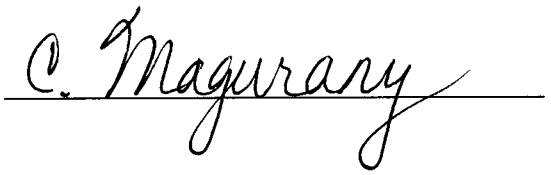

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